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DOW THEORY LETTERS

"The Market as Interpreted under the Dow Theory"

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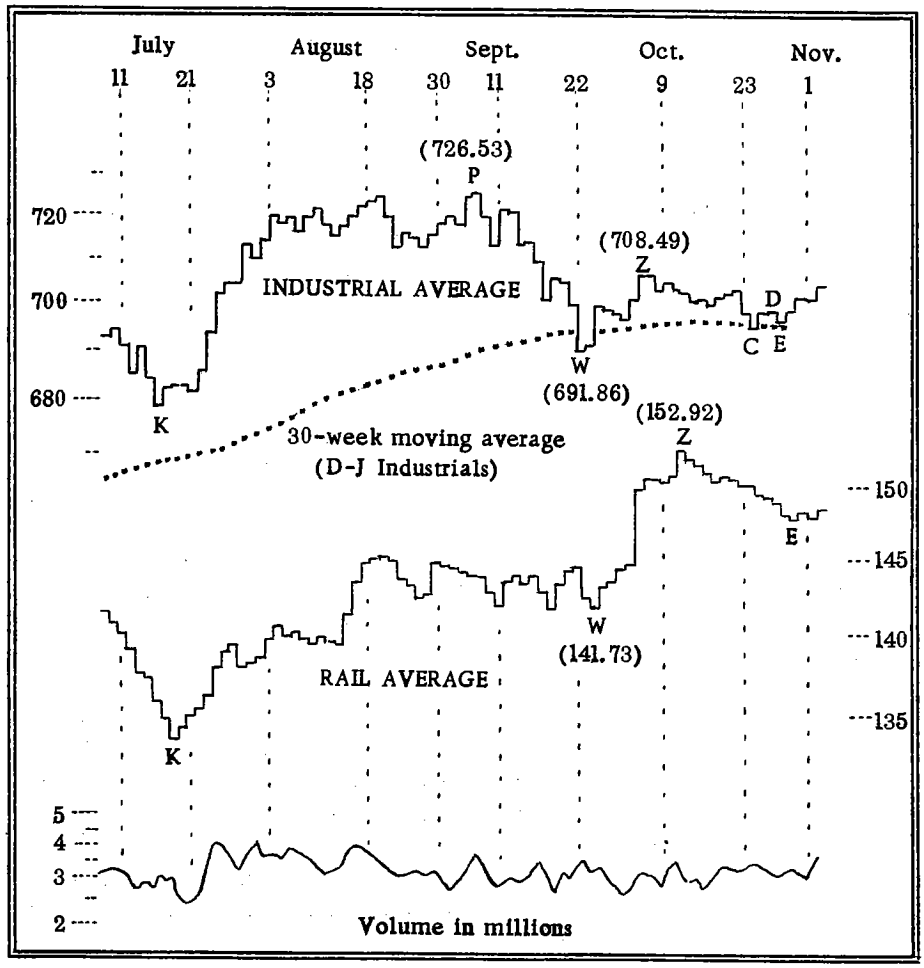
THE MARKET The last Letter drew attention to the violent 11 point Rail rally from W to Z (see chart). "It would now be normal," said Letter 160, "to see the carriers correct the move. In that case, the Rail Average could retrace at least 1/3 to 1/2 of the W-Z rally (taking them back to the 147-49 area). If Industrials hold above W (691.86) on such a decline and volume contracts, the decline will not be without bullish implications."

From their September 11 peak of 152.92 (Z), the carrier Average declined on 12 out of 13 sessions. By October 30 Rails had dropped to 147.63 (at E), exactly 31¢ above the halfway level of the W-Z rally (the halfway point was 147.32). This writer was impressed by the fact that following the violent Rail rally and following a correction which included 12 out of 13 days of decline, the carriers, nevertheless, were able to retain better than half of the W-Z gains.

Over the same period, the Industrials put on a constructive performance. The senior Average established a decline low at C (697.24) rallied, then traced a second (higher) decline level at E. At E volume receded to the lowest level in two weeks, giving the E point the appearance of a "buy-spot".

On October 31 Industrials advanced and bettered the D point, thereby forming an upward zig-zag.

Following a sustained period of market weakness (such as the one which has been going on since May of this year), selling pressure must subside before buying sentiment can be revived. The action of the market over the last few weeks suggests a cessation of selling pressure. Buying power, however, has been cautious and sporadic. Since mid-September the advance-decline ratio and the new-high index have shown definite signs of improvement. In the face of this strengthening undercurrent, the odd-lot public has seen fit to sell and sell short. The evidence at hand suggests that the next important move will be up.



Conclusion: If Industrials better the Z (708.49) level with Rails advancing "in gear", the two Averages will be in a position to try for the bull market highs. An Industrial bettering of P (726.53) with a confirming Rail bettering of Z (152.92) would set the stage for a major upward swing.

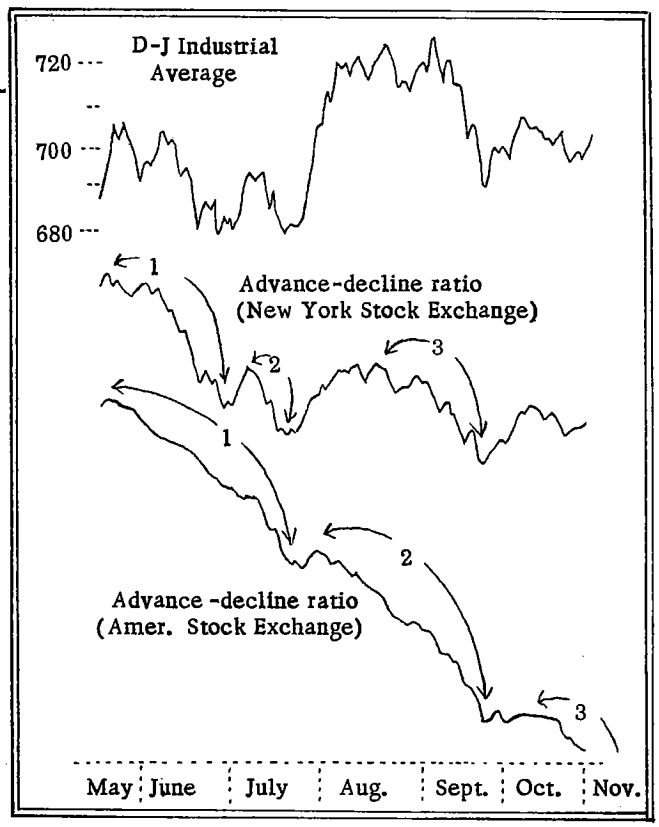
The primary trend or major force of the market is bullish. The secondary trend is bullish and will be considered to remain so as long as one or both Averages hold above the W points (Industrials 691.86, Rails 141.73).

NEGATIVE STRENGTH Eight weeks have passed since the Industrial all-time high (726.53) of September 7; three weeks have elapsed since the Rail high (152.92) of October 11. With both Averages well off their 1961 peaks, it is worth remembering that inferences can often be drawn from what the market does not do (as well as from what it does do).

 On September 25 the 5-day average of new lows (a gauge of market weakness) touched a 1961 record of 53. That total has not since been approached or surpassed (the 5-day average of new lows as of November 1 was 26). A persistent refusal by the new low index to pass the 5-day average of 53 will be considered a hopeful sign.

On September 23 and 24 the Industrial Average dipped temporarily below its own long-term 30-week moving average (see chart on page 1). No downside momentum was forthcoming from that penetration, and the Industrial Average immediately snapped back above the moving average. In the period since September 23, the Industrial Average has been hovering a few points above the moving average. The longer the Industrial Average holds or consolidates above the moving average without a decisive downside "break-away" (on increasing volume), the more hopeful the situation (and the greater the potential upward swing).

A study of the advance-decline ratio (A-D ratio) on the New York Stock Exchange (see chart) is also informative at this juncture. Through May and June the A-D ratio (representative of the advancing or declining tendencies of all stocks traded on the Exchange) dropped steeply. This is shown on the chart by leg number 1. The second downward leg on the A-D ratio took the ratio to a low in July. Following an upward correction, a third leg on the A-D ratio took that indicator to a third low in September. Subsequent to the September low, the A-D ratio worked slightly higher, rounded over, then declined half-heartedly again. As of this writing (see chart), the September low has held intact.



On the hopeful side is the fact that many market declines (both on individual stocks and on the Averages) go through three distinct downward legs and terminate with the third leg. With this in mind, there is a strong possibility that the September low on the A-D ratio represented the end of the general market decline.

The dismal performance of the mass of stocks on the speculative American Exchange (as represented by the A-D ratio on that Exchange) continues as of this writing, but here too, one can make a case for an end to the decline over the near future. The American A-D ratio would now seem to be on its third downward swing. Following the termination of the current decline, we might expect at least a substantial upward correction of the long, painful descent of the majority of stocks on the "junior" Exchange.

STOCKS I have been doing an increasing amount of research on individual stocks and their relationship to their own moving averages (M. A.). As a result of this study, I have slowly come to the conclusion that a 10 week M. A. is preferable to a 30-week M. A. The reasons for this are three-fold: (1) a ten-week M. A. is obviously more sensitive than a 30-week M. A., (2) a 10-week M. A. is mechanically easier to compute than a 30-week M. A., (3) a 10-week M. A. requires less research to construct than a 30-week M. A. (only 10 preceding Friday figures are needed instead of 30).

Since a 10-week M. A. is more sensitive (and will usually be nearer the actual market price of the stock) than a 30-week M. A., the question is -- won't one get "whip-sawed" too frequently if one uses a 10-week M. A.? The answer is -- not necessarily if he adheres to two rules: (1) the 10-week M. A. is used with a 3-week delay in plotting, (2) a penetration through the M. A. by a full 5% (7 1/2% if the stock is under $20.00, 3% if the stock is over $50.00) is required, and this penetration must be in effect as of Friday's closing. In other words, action is taken only on the price of the stock at the end of the week, regardless of what may have happened earlier in the week (a few readers may recognize these rules as those developed by Mr. Curtiss Dahl, author of the book "Consistent Profits in the Stock Market." The book is obtainable from Tri-State Offset Co., 817 Main St., Cincinnati 2, Ohio - $20.00).

Utilizing only the Friday close means that action (buying or selling) is usually taken Monday morning. As to why the Friday close only is used, it has been demonstrated that regardless of action earlier in the week, by Friday afternoon the market has usually calmed down, floor traders have "cleared out" for both the day and the weekend, and price movements are apt to have more validity at the culmination of five days of steady trading.

The question may also be asked -- "From the standpoint of trading, what makes you think that the 10-week M. A. with a 3-week delay is better than a 30-week M. A.?" The answer is empirical -- I have tried it and it works better than the 30-week M. A.

For purposes of illustration, I have prepared a chart which shows the easiest method of keeping the 10-week M. A. with a 3-week delay. Each week the new Friday closing price is entered in Column 1. This same figure is then added to the last total in Column 2, while at the same time the eleventh Friday closing is dropped (subtracted). Thus we have a constant running total of the last 10 Friday closings in Column 2 (with the new figure added each week and the eleventh figure subtracted). Column 3 consists simply of the 10-week total from Column 2 divided by 10 (which provides the actual 10-week average price or M. A.). The figure from Column 3 is then dropped down three spaces (or three weeks) in Column 4 (as shown by the arrows), which provides the 3-week delay on the M. A.

For example, on 10/6 the total for the last Fridays on U. S. Steel was 839. 97 (Column 2). The actual M. A. (839. 97 divided by 10) was 83. 99 (Column 3). This figure is then moved down 3 spaces to 10/27 (in Column 4). Three weeks later, on 10/27, U. S. Steel closed (Friday) at 75. 87. So the 10/27 price of 75. 87 is plotted on the chart together with the 83. 99 M. A. figure in Column 4. Thus our chart should show the 10/27 (Friday) close for U. S. Steel plotted together with the M. A. figure of 3 weeks before.

This process is so simple and consumes so little time, than anyone should be able to keep 10 to 20 charts each week with the sacrifice of perhaps 15 minutes of time.

U. S. STEEL

	1	2	3	4
Date (Fri.)	Friday closing price	Total of the last 10 weeks (add last 10 figures in column 1)	10-week average (divide column 2 total by 10)	3-week delay (drop column 3 figure 3 spaces)
8/4	88.50 X			
8/11	87.00 X			
8/18	85.62 X			
8/25	84. 87			
9/1	85. 37			
9/8	84. 00			
9/15	83. 00			
9/22	80. 37			
9/29	79. 87			
10/6	81. 37	839. 97	83. 99	
10/13	79. 50	830. 97	83. 09	
10/20	78. 37	822. 34	82. 23	
10/27	75. 87	812. 59	81. 25	83. 99
				83. 09
				82. 23
				81. 25

TRADING POINTS: When a stock registers a Friday closing above or below its M. A. by the required 5%, it should be purchased or sold (or sold short) on the Monday morning of the following week. Once action is taken, no "stop losses" are placed during the first week. However (in the case of a purchase), at the start of the second week a "stop-loss" is placed 5% below the lowest price registered by the stock during the first week. The stop-loss procedure is continued for 10 successive weeks, and each week the stop is placed 5% under the preceding week's lowest price. Stops are advanced as (or if) the lowest price of the preceding week advances. Stops are only moved up during the 10-week period, never down. At the termination of the 10-week period the stop is removed, and the stock is then sold only on a downward penetration (by 5%) of the M. A. (the exact opposite procedure is used for short sales -- with "stop-buy" orders being utilized instead of stop-loss orders).

Many subscribers may not care for the short side. During confirmed bull markets the short side always presents great risks (although the opposite is true during bear markets). I have no objection to skipping short-sales during bull markets.

Be wary of a stock that is bullish when the rest of its group is bearish. Few stocks in a bearish group will outperform the group over any extended period of time. In general, buy stocks in neutral or strong groups.

If the price pattern of a stock is in a bullish formation (triangle, inverse head-and-shoulders or a line) and the stock then breaks above its M. A., so much the better. This constitutes a double confirmation of a potential bullish move.

If the short position in an individual stock has been rising for three months or more, this will usually lend impetus to any upward move or "breakout". Be wary of buying stocks that show a persistent decline in their short position.

STOCKS Standard Oil of New Jersey hit a high of 68 1/2 in 1957, then broke to 38 in 1960. J turned bullish in March of this year (see chart), then broke temporarily below its 10-week M.A. The stock bottomed out in July, rallied feebly and then returned to "test" the July low in late September. Most recently J has acted extremely well, and last week the stock finally bettered its 10-week moving average again (M.A. is now 44 3/8). The short position in J has increased over the last two months, and I list J as a stock to buy at the market.

The strongest groups on the "Board" now are Containers, Investment Companies, Office Equipment, Papers, Retail Stores, Rubbers, Soft Drinks, Tobaccos and Utilities. In the Paper Group I have already mentioned International Paper and St. Regis Paper as buys.

The accompanying chart shows the daily movements of Crown Zellerbach. ZB has been in a strong uptrend since the June – July correction, and I believe it can now be bought. A rise above the trendline at 63 should touch off a renewed advance.

In the strong Tobacco group, Lorillard is in a favorable position. The stock rose to a high in October of this year, then corrected on sharply decreased volume. Note that the correction held well above the ascending trendlines which is now at about 58. I feel that LL can be bought at the market.

THE "WIND-UP" On November 2 Industrials continued their climb and Rails formed a tiny upward zig-zag. If the market has any upside potential, the advance should now be on its way.

(Written Friday, November 3, 10 A.M.)

Charts of ZB and LL courtesy of Traders Research, P.O. Box 6185, Lambert Airport, Mo.